

Internal Revenue Service

Number: **200703015**

Release Date: 1/19/2007

Index Number: 106.00-00, 115.00-00

Department of the Treasury

Washington, DC 20224

Third Party Communication: None

Date of Communication: Not Applicable

Person To Contact:

, ID No.

Telephone Number:

Refer Reply To:

CC:TEGE:EB:HW

PLR-120638-06

Date:

October 14, 2006

Legend

Taxpayer =

Trust =

County =

State =

Statute =

Dear :

This is in reply to your letter dated April 2, 2006, and subsequent correspondence, in which you request various rulings on behalf of Taxpayer.

Taxpayer is a joint powers agency administered by the County Superintendent of Schools Office, created under State Statute. As a joint powers agency, Taxpayer is a political subdivision of State. Taxpayer provides health benefits to retirees, and their spouses and dependents, of participating public schools, colleges, and education agencies in State.

Taxpayer is governed by a board comprised of a minimum of thirteen members elected by the members of Taxpayer and one member selected by the Superintendent of

Schools of County. Taxpayer receives income from the premiums paid by its participating members. Taxpayer has an operating fund that is used to pay insurance premiums, broker's fees, adjusting fees, consultant fees, legal fees and other administrative fees. The operating fund is deposited in the County Treasury. Upon termination of the joint powers agreement by all parties, all remaining assets will be distributed to Taxpayer's members.

Effective July 1, 2006, Taxpayer adopted an agreement establishing a Trust to pre-fund its participating public schools, colleges, and education agencies retiree medical benefits. An amended Trust agreement was executed on September 8, 2006. Trust is intended to be an irrevocable trust under applicable law of State. The Trust agreement provides that public schools, colleges and educational agencies that sign a participation agreement in accordance with the bylaws of Taxpayer may become participating employers in the medical retirement plan provided by the Trust agreement. Taxpayer amended the Trust agreement to provide that in no case may an organization that is not a state, a political subdivision or an entity the income of which is excluded from gross income under section 115 of the Internal Revenue Code (the Code) become a participating employer in the Trust.

The Trust is administered by an administrator. Originally the Trust agreement provided that the administrator was to be designated by Taxpayer. However, Taxpayer amended the Trust agreement to provide that the administrator is designated by Trust's participating employers. The Trust funds are managed by a trustee who is appointed by, and can be removed by, the administrator. The trustee is authorized to exercise all powers conferred upon trustees by law which it may deem necessary or proper for management and protection of the Trust assets. The funds are to be held, disbursed and administered by the trustee for the exclusive benefit of the employees of the participating employers and cannot be used for any other purpose. Participating employers make all contributions to Trust. No contributions are made by employees or retirees. Trust assets will be used solely for the payment of health benefits of the retirees who participate in Trust and for payment of the cost of administering Trust. The Trust's funds will not be used for any purpose other than the exclusive benefit of the individual participating retirees, their spouses and dependents.

Upon termination of Trust, Trust assets will be used to pay Trust obligations and distributed to the participating retirees to fulfill the obligations of the participating employers under Trust. Any overages in the contribution of a participating employer in excess of its obligation under Trust to pay for health benefits are returned to the participating employer. Trust provides that assets that remain dedicated to the payment to the participating retirees of the obligations of the participating employer under Trust may, upon termination of Trust, be transferred to another tax-exempt entity. Taxpayer amended the Trust agreement to provide that in no case will the assets be transferred to an entity that is not a state, political subdivision of a state or an entity the income of which is excluded from gross income under section 115.

Section 115(1) of the Code provides that gross income does not include income derived from any public utility or the exercise of any essential government function and accruing to a state or any political subdivision thereof.

In Rev. Rul. 77-261, 1977-2 C.B. 45, income from an investment fund, established under a written declaration of trust by a state, for the temporary investment of cash balances of the state and its participating political subdivisions, was excludable from gross income for federal income tax purposes under section 115(1). The ruling indicated that the statutory exclusion was intended to extend not to the income of a state or municipality resulting from its own participation in activities, but rather to the income of a corporation or other entity engaged in the operation of a public utility or the performance of some governmental function that accrued to either a state or municipality. The ruling points out that it may be assumed that Congress did not desire in any way to restrict a state's participation in enterprises that might be useful in carrying out projects that are desirable from the standpoint of a state government and which are within the ambit of a sovereign to properly conduct. In addition, pursuant to section 6012(a)(2) and the underlying regulations, the investment fund, being classified as a corporation that is subject to taxation under subtitle A of the Code, was required to file a federal income tax return each year.

In Rev. Rul. 90-74, 1990-2 C.B. 34, the Service determined that the income of an organization formed, funded, and operated by political subdivisions to pool various risks (casualty, public liability, workers' compensation, and employees' health) is excludable from gross income under section 115 of the Code. In Rev. Rul. 90-74, private interests neither materially participate in the organization nor benefit more than incidentally from the organization.

By helping the public school districts and other public employers that participate in Trust to provide health benefits for their retirees, Trust performs an essential governmental function within the meaning of section 115(1) of the Code.

The income of Trust accrues to the participating employers that adopt the program provided by Trust. All participants in the program are states, political subdivisions of state or entities the income of which is excluded from gross income under section 115 of the Code. No private interests participate in or benefit from the operation of Trust other than as providers of goods or services. Any benefit to the employees of participating employers is incidental to the public benefit. See Rev. Rul. 90-74.

Section 61(a)(1) of the Code provides that, except as otherwise provided, gross income includes all income from whatever source derived, including compensation for services.

Section 106(a) of the Code provides that gross income of an employee does not include employer-provided coverage under an accident or health plan.

Section 1.106-1(a) of the Income Tax Regulations provides that the gross income of an employee does not include contributions which his employer makes to an accident or health plan for compensation (through insurance or otherwise) to the employee for personal injuries or sickness incurred by him, his spouse, or his dependents, as defined in section 152. The employer may contribute to an accident or health plan either by paying the premium (or a portion of the premium) on a policy of accident or health insurance covering one or more of his employees, or by contributing to a separate trust or fund (including a fund referred to in section 105(e)) which provides accident and health benefits directly or through insurance to one or more of his employees.

Coverage provided under an accident and health plan to former employees and their spouses and dependents is excludable from gross income under section 106. See Rev. Rul. 62-199, 1962-2 C.B. 32; Rev. Rul. 82-196, 1982-2 C.B. 53.

Based on the information submitted and representation made, and contingent upon Taxpayer filing the amended Trust agreement, dated September 8, 2006, with the State, we conclude as follows:

- (1) The income of Trust is excludable from gross income under section 115(1).
- (2) Employer contributions paid to Trust and payments made from Trust which are used exclusively to pay for the accident or health coverage of retired employees, their spouses and dependents are excludable from the gross income of retired employees and retired employees' spouses and dependents under section 106 of the Code.

No opinion is expressed concerning the Federal tax consequences of Trust under any other provision of the Code other than those specifically cited above.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

Sincerely,

Harry Beker, Branch Chief
Health and Welfare Branch
Office of Associate Chief Counsel/Division
Counsel (Tax Exempt and Government Entities)

cc: